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FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

July 17, 1998

Memorandum

Audit Referral 98-04

To: Lawrence M. Noble
General Counsel

Through: John C. Surina
Staff Director

From: Robert J. Costa *pln For RJC 7-17-98*
Assistant Staff Director
Audit Division

Subject: 1996 Democratic National Convention Committee, Inc. - Matters Referred
to the Office of General Counsel

On June 25, 1998, the Commission approved the Audit Report on the 1996 Democratic National Convention Committee, Inc. Based on the Commission approved Materiality Thresholds, two findings from the report are being referred to your office: Finding II.A.2., Apparent Convention Committee Expenses Paid by the Host Committee and City of Chicago -Telecommunications and Finding II.E., Apparent Allocable Convention-Related Expenses.

All workpapers and related documents are available for review in the Audit Division. Should you have any questions, please contact Wanda Thomas or Rick Halter at 694-1200.

Attachment as stated.

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II. AUDIT FINDINGS AND RECOMMENDATIONS — AMOUNTS DUE TO THE U.S. TREASURY

A. APPARENT CONVENTION EXPENSES PAID BY THE HOST COMMITTEE AND CITY OF CHICAGO

Section 9008(h) of Title 26 of the United States Codes states, in part, that the Commission shall have the same authority to require repayments from the national committee of a political party as it has with respect to repayments from any eligible candidate under section 9007(b).

Section 9008.3(a)(4)(vii) of Title 11 of the Code of Federal Regulations states, the convention committee shall agree to comply with the applicable requirements of 2 U.S.C. 431 et seq., 26 U.S.C. 9008, and the Commission's regulations at 11 CFR Parts 100-116 and 9008.

In addition, Section 104.3(a) of Title 11 of the Code of Federal Regulations states, in part, that each report filed under 104.1, shall disclose the total amount of receipts for the reporting period and for the calendar year and shall disclose the information set forth at 11 CFR 104.3(a)(1) through (4).

Section 9008.12(b)(3) of Title 11 of the Code of Federal Regulations states, in part, if the Commission determines that contributions accepted to defray convention expenses which, when added to the amount of payments received, exceeds the expenditure limitation of such party, it shall notify the national committee of the amount of the contributions so accepted, and the national committee shall pay to the Secretary an amount equal to the amount specified.

Section 9008.12(b)(7) of Title 11 of the Code of Federal Regulations states, in part, that the Commission may seek a repayment from the convention committee if the convention committee knowingly helped, assisted or participated in making convention expenditures by the host committee, governmental agency or municipal corporation that are not in accordance with 11 CFR §§9008.52 or 9008.53.

Section 9008.52(c) of Title 11 of the Code of Federal Regulations states, in part, that contributions received by host committees may be used to defray those expenses incurred for the purpose of promoting the suitability of the city as a convention site; to defray those expenses incurred for welcoming the convention attendees to the city, such as expenses for information booths, receptions, and tours; to defray those expenses incurred in facilitating commerce, such as providing the convention and attendees with shopping and entertainment guides and distributing the samples and promotional material specified under 11 CFR §9008.9(c); to defray the administrative expenses incurred by the host committee, such as salaries, rent, travel, and liability insurance; and to provide the national committee use of an auditorium or convention center and to provide construction and convention related services for that location such as: construction of podiums; press

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tables; false floors; camera platforms; additional seating; lighting; electrical, air conditioning, and loudspeaker systems; offices; office equipment; and decorations.

Further, contributions may be used to defray the cost of various local transportation services, including the provision of buses and automobiles; to defray the cost of law enforcement services necessary to assure orderly conventions; to defray the cost of using convention bureau personnel to provide central housing and reservation services; to provide hotel rooms at no charge or a reduced rate on the basis of the number of rooms actually booked for the convention; to provide accommodations and hospitality for committees of the parties responsible for choosing the sites of the conventions; and to provide other similar convention facilities and services.

Section 9008.7(a)(4) of Title 11 of the Code of Federal Regulations states that "Convention expenses" include all expenses incurred by or on behalf of a political party's national committee or convention committee with respect to and for the purpose of conducting a presidential nominating convention or convention-related activities.

Background

The Audit staff identified payments made by and contributions to Chicago's Committee for '96 (the Host Committee) and payments made by the City of Chicago (the City) relative to several vendors totaling \$2,580,742, which appear to be for convention-related expenses and not for items noted above at 11 CFR §9008.52(c). Most of the information pertaining to the vendors was obtained as a result of our audit of the Host Committee.

On August 4, 1994, the City of Chicago and the 1996 Democratic National Convention Committee, Inc. entered into a written agreement (the Convention Contract or Contract). One section of this agreement provided for the establishment of a host committee to serve, in part, as a separate fund to satisfy the financial obligations of the City specified in the Convention Contract, and, for securing cash and in-kind contributions necessary to obtain goods and services needed for the Convention. The Host Committee formally registered with the FEC on August 16, 1994 as Chicago's Committee for '96.

On August 19, 1996, the City and the DNCC amended the Contract, in part, with a budget revision entitled "Chicago '96/City Budget." Each expense classification in the revised budget was identified by line number, line item, total amount budgeted, total cash spent, and total in-kind contributions allocated to that line item. The Audit staff's review of management controls disclosed that the Host Committee's disbursement records included memoranda which identified expenditures made on behalf of the DNCC and the budget line number to which each expense should be allocated. The apparent objective of these controls was to facilitate managerial reporting and compliance with the budget. Furthermore, the Host Committee obtained written concurrence from the DNCC for all of the payments. In accordance with the Convention

Contract, expenses defrayed fell into one of two major budgetary classifications, production expenses or telecommunications costs, as discussed below.

The issue of the permissibility of these payments was addressed in Exit Conference Memoranda (ECM) resulting from the audits of both Chicago '96 and the DNCC. Both committees, as well as the City of Chicago, were given an opportunity to respond to the Memoranda, and information provided by them is incorporated in the discussions below.

In response to the respective Exit Conference Memoranda, both the DNCC and the Chicago's Committee for '96 argued that most or all of the expenses discussed below are covered by one of the categories of permissible host committee expenses at 11 CFR §9008.52(c)(1) or, referring to 11 CFR §9008.52(c)(1)(xi), are "similar" to expenses covered by one of the permissible expense categories. To read 11 CFR 9008.52(c)(1) as broadly as both committees propose would effectively negate the limitation on convention expenses at 26 U.S.C. §9008(d); the prohibition on contributions to a convention committee that has received the full federal payment (11 CFR §9008.6(a)); the prohibition on the use of corporate contributions in connection with federal elections at 2 U.S.C. §441b; and the Commission's clear statement in the *Explanation and Justification* (E&J) supporting the provisions contained in 11 CFR 9008.52(c)(1) that allowing the host committee to pay selected convention expenses is "intended to be a very narrow exception to the statutory limitation on convention expenses."¹

2. Telecommunications

Section 9008.7(a)(4)(x) of Title 11 of the Code of Federal Regulations states that "Convention Expenses" include all expenses incurred by or on behalf of a political party's national committee or convention committee with respect to and for the purpose of conducting a presidential nominating convention or convention-related activities. Such expenses include administrative and office expenses for conducting the convention, including stationery, office supplies, office machines, and telephone charges; but exclude the cost of any services supplied by the national committee at its headquarters or principal office if such services are incidental to the convention and not utilized primarily for the convention.

As mentioned above, 11 CFR §9008.52(c) permits host committees to provide the national committee use of a convention center and convention-related services for that location such as offices and office equipment. In addition, an explanation of the regulatory intent behind 11 CFR §9008.52(c), printed in the *Federal Register* (Vol. 59, No. 124, Page 33614), states, in part, that the revised rules do not permit host committees or municipalities to pay the convention committee's or the national party's overhead and administrative expenses related to the convention.²

¹ See 44 Fed. Reg. 63,038 (Nov. 1, 1979).

² See 59 Fed. Reg. 33,614 (June 29, 1994).

Pursuant to the Convention Contract, the City agreed: to provide the DNCC with a telecommunications system; to provide the DNCC with a cellular phone system; and, to pay for all long distance service charges incurred by the DNCC at the Convention facilities. The Audit staff's review of disbursements disclosed that the Host Committee and City made substantial payments on behalf of the DNCC for telephone installation and service. Because telephone installation costs are allocable to office equipment, and therefore are permissible host committee expenses pursuant to 11 CFR §9008.52(c)(1)(v), the following discussion focuses on telephone service charges.

According to Host Committee records, payments totaling \$600,325 were made to defray local and long distance telephone service charges. Furthermore, documents obtained by the Audit staff indicate that the City of Chicago paid an additional \$126,510.³ These payments were apparently made in execution of the Contract's provisions related to telecommunications and are discussed in more detail below.

a. Ameritech

In the Exit Conference Memorandum (ECM), the Audit staff identified 10 payments to Ameritech, which net of refunds to the Host Committee from the vendor, totaled \$512,637. In addition, payments by the City totaling \$105,621 were identified. A review of the invoices disclosed that all of the billings were local telephone service charges for Convention telephone numbers or accounts apparently assigned to the DNCC. Furthermore, internal Host Committee memoranda attributed all of the expenses to the DNCC.

b. AT&T

The Audit staff identified 15 payments by the Host Committee to AT&T, totaling \$87,688. A review of the invoices disclosed that all of the billings were long distance telephone service charges for Convention telephone numbers or accounts apparently assigned to the DNCC. Furthermore, internal Host Committee memoranda attributed all of the expenses to the DNCC. Payments by the City totaling \$20,889 to AT&T were also identified.

In the ECM, the Audit staff concluded that service charges for telephone calls made by the DNCC in support of its operations were a convention overhead expense which did not contribute to preparation of convention center premises or promotion of the City of Chicago. Therefore, the \$600,325 paid by the Host Committee and \$126,510 paid by the City for telephone service charges, result in in-kind

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contributions to the DNCC. The Audit staff also recommended that the Committee provide documentation to demonstrate that the payments for telephone service charges were allowable Host Committee or City expenses pursuant to 11 CFR §9008.52(c) and did not result in prohibited in-kind contributions to the DNCC.

In its response, the DNCC argued that "by any reasonable reading, the regulation on its face [emphasis in original] authorizes the host committee to pay for the costs of telephone service for the Convention." In the DNCC's opinion, "[t]o say that the costs of office telephones are not an overhead or administrative expense but that the costs of using the telephones are such an expense is to draw a distinction that no reasonable reading of the plain language of the regulation would support." The DNCC then criticized the "language of the Explanation and Justification (E&J)," declaring that it should "not be given precedence over the plain language of the regulation," and that "the E&J language is itself ambiguous."

The Host Committee took a different approach in its response, stating that the telecommunications systems "existed for the benefit of Chicago '96" and that without having provided these services, it would have been impossible for the Committee to fulfill its obligations under the Convention Contract. The Host Committee asserted that the "telecommunications system served to accomplish a wide variety of tasks directly related to the Convention" including construction as well as security. The Host Committee concluded that expenditures for the phone charges "fall within the parameters of 11 C.F.R. Section 9008.52(c)," and therefore, it was appropriate to pay for them.

Despite the arguments presented above, the Audit staff believes that the E&J offers a reasonable starting point for applying the regulations as intended by the Commission. The Audit staff further concludes that charges for local and long distance telephone calls made by the DNCC are most appropriately classified as administrative and overhead expenses of the convention committee and not construction or security expenses benefiting the host committee. Therefore, the total amount of \$600,325 paid by the Host Committee and \$126,510 paid by the City for telephone charges, result in in-kind contributions to the DNCC.

Recommendation #1

The Audit staff recommends that the Commission determine that the Host Committee made in-kind contributions totaling \$600,325, and the City of Chicago made an in-kind contribution of \$126,510, and that this total of \$726,835 is repayable to the United States Treasury. In addition, the Committee should file an amended disclosure report and itemize these in-kind contributions.

E. APPARENT ALLOCABLE CONVENTION-RELATED EXPENSES

During our review of background materials related to the convention, we identified a possible in-kind contribution to the DNCC. According to published reports,⁴ the Democratic National Committee was assuming about \$25,000 in hotel bills incurred at the Chicago convention in August, 1996, "partly because of concerns that a donor who originally paid the bill might have used foreign funds, according to sources." The hotel bill reportedly covered costs associated with Democratic National Committee finance chairman Rosen's stay in the presidential suite at Chicago's Four Seasons, R. Scott Pastrick's stay in a smaller suite, and two additional rooms.

Mr. Pastrick served as treasurer of the DNCC from October 5, 1995 to January 20, 1997, and also served as treasurer of the DNC Services Corporation/ Democratic National Committee, Democratic Unity Fund, and six other committees registered with the Commission, according to the FEC Disclosure Data Base for the 95-96 cycle. The DNCC did not defray the cost of Mr. Pastrick's hotel expenses during convention week. During fieldwork, the Audit staff requested copies of the hotel bill and related expenses and information concerning the payment of these expenses. Also requested was information as to why no portion of these expenses relate to the convention, even though Mr. Pastrick and Mr. Rosen were both present during convention week and met with persons attending the convention.

The DNCC responded by stating that "during the week of the convention, Mr. Pastrick's sole function, other than a five minute speech at the Monday Convention session, was to serve in a fundraising capacity for the DNC [Democratic National Committee]." The DNCC went on to explain that there was no point during the week of the convention where Mr. Pastrick was required to serve in the role of treasurer of the DNCC. A copy of Mr. Pastrick's remarks of August 26th was provided. He was introduced as "Treasurer of the Democratic National Committee." In his remarks, Mr. Pastrick made references to Party finances, campaign finance reform, and the November general election. Information relating to the hotel expenses and payment thereof was not provided.

In the Audit staff's opinion, the expenses associated with Mr. Pastrick's suite during convention week would seem, at least in part, allocable to the DNCC, as would the two additional rooms, given his position and responsibilities as the DNCC treasurer.

In the ECM, the Audit staff requested that the DNCC provide support for its position. The documentation was to include (a) copies of the hotel bill and related expenses for Mr. Pastrick's suite and the two additional rooms, (b) information concerning the payment of these expenses, (c) a copy of Mr. Pastrick's appointment calendar or other written record of his activities during convention week, and (d) any additional information the DNCC believes is relevant in support of its current position.

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In its response to the ECM, the DNCC did not submit any of the documentation requested in the ECM in support of its position. The DNCC did reiterate the points discussed above and further stated:

[I]t is fundamental to the Convention financing system that the costs of national party fundraising at the Convention should not be paid for with public Convention grant. 11 CFR §9008.7(a)(4)(viii)(B). Thus, it is clear that no part of Mr. Pastrick's expenses should have been allocated to the DNCC." The Audit Division's insistence that part of the expenses of a Party official to attend the Convention should be charged to the public. The Audit Division's position, were the Commission to uphold it, would be an open invitation for future abuse--an invitation to national party committees to slough off part of their fundraising costs on the taxpayers. That is exactly what the Commission should be discouraging, not encouraging. The Audit staff's hunt for further documentation, proof of Mr. Pastrick's activities during the Convention, etc., is pointless and counterproductive. His expenses were properly paid for by the DNC.

Given the lack of documentation provided in response to the request contained in the ECM, the Audit staff's position is unchanged.

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